This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 HO CHI MINH CITY 001146

SIPDIS

SENSITIVE

DEPARTMENT PLEASE PASS USTR, ELENA BRYAN
DEPARTMENT FOR EAP/MLS AND EB/TPP/ABT/BTT
USDOC FOR OTEXA
BANGKOK FOR CUSTOMS ATTACHE
USDOC ALSO FOR 4431/MAC/AP/OPB/VLC/HPPHO
TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: ETRD ECON KTEX VM BTA WTO LABOR
SUBJECT: VIETNAM TEXTILES: COMPETING IN A QUOTA-FREE WORLD

REF: A) HANOI 2390 B) HCMC 178

SUMMARY

¶1. (SBU): Vietnam's apparel exports to the United States have boomed since the entry-into-force of the BTA. However, the Vietnamese garment industry is beginning to feel the pinch of being one of the only countries still subject to textile quotas. Vietnam is not reaping any benefit from safeguard actions in China, as originally anticipated. According to industry experts, rising labor costs, labor shortages in the HCMC area, and high transport and input costs have affected the volume of Vietnam's exports in 2005. At the same time, other Asian nations not bound by quotas, like Indonesia and Bangladesh, have done a better job than Vietnam at filling the gap created by safeguards against China. Industry representatives report that the benefits to Vietnam of entering the WTO to escape quotas may not be as great as previously expected. END SUMMARY.

BOOMING APPAREL EXPORTS WITH BTA

¶2. (SBU) According to the Vietnam Textile and Apparel Association (VITAS), Vietnam's garment exports to the United States went from less than USD 50 million in 1999, the year prior to the signing of the U.S.-Vietnam Bilateral Trade Agreement (BTA), to USD 2.7 billion in 2004. Industry experts have traditionally cited Vietnam's low labor costs combined with production of consistently high-quality goods as the main reasons for Vietnam's high degree of competitiveness world-wide, a competitiveness that continued following the imposition of U.S. quotas. According to one U.S. buyer who has been based in Vietnam for 11 years, the Vietnamese adopted their high standards in product quality originally to meet the demands of Japanese buyers, and these standards have aided the Vietnamese in developing a U.S. market for their goods.

¶3. (SBU) While the majority of garment factories are located in the Ho Chi Minh City area, increased exports to the United States have been a boon to factories located elsewhere, including factories clustered in central Vietnam. For example, General Director Tran Van Pho has transformed the Hoa Tho Textile-Garment Company (HOTEXCO) from a run-of-the-mill state-owned factory and spinning mill to one of the region's largest textile and garment concerns. HOTEXCO, which is part of the national state-owned enterprise (SOE) Vinatex, operates six factories in Danang City and Quang Nam province that employ 4,000 workers and produce dresswear, sportswear and outerwear for the likes of Perry Ellis, Nautica, Haggar, Puma and Target. In 2000, the year before the BTA entered into force, HOTEXCO exported USD 2.4 million in garments. In 2004, the company exported USD 34 million and is likely to top USD 40 million in exports in 2005. Sixty percent of the company's products are exported to the United States. Mr. Pho credited the BTA as the key to HOTEXCO's rapid growth and noted that limits imposed by U.S. quotas have not dramatically affected HOTEXCO since some of its apparel products are not subject to quota. He is looking forward to equitizing the company in the near future.

GARMENT EXPORTS TO THE UNITED STATES WEAKENING IN 2005?
--- ----------

¶4. (SBU) The boom in garment exports to the United States of the last five years may be easing, however, even as Vietnam is poised to enter the World Trade Organization and benefit from the removal of U.S. quotas. VITAS reported to EconOff that in the first half of 2005, Vietnam has not adequately met its garment export targets, and exports to the United States and European Union are down from the same period in 2004. According to VITAS, Vietnam exported a total of USD 4.4 billion in garments in 2004 and set an export target of USD 5.2 billion for 2005. In the first six months of 2005, garment exports reached USD 2.05 billion, less than half the national target for the year. The lower-than-expected numbers can be traced in part to the fact that, in the first six months of 2005, exports of garments to the United States fell by 2.8 percent and exports to the EU fell by 10.4 percent, compared to the same period in 2004. However, exports to Japan

rose by 12.8 percent in this period. VITAS reported that May to September is the peak season for garment exports in Vietnam and that export numbers are usually higher in the second half of the year, compared to the first half.

¶5. (SBU) Underutilized U.S. quota reflects the decline in exports to the United States in the first part of the year, according to HCMC-based U.S. buyers. These buyers forecast that only a handful of the 38 garment categories subject to quota in Vietnam would by fully utilized by year's end. U.S. Customs reported that as of October 26 less than 50 percent of quota had been filled in 15 of 38 categories.

DECLINING VIETNAMESE COMPETITIVENESS

¶6. (SBU) HCMC experts reported that underutilized quota is not the main reason for the decline in exports to the United States in the first half of 2005. In their view, Vietnam's competitiveness in the apparel industry has declined in the face of increased competitiveness from other Asian nations, including Indonesia, Bangladesh, India and Sri Lanka. Many thought Vietnam would benefit from safeguards imposed on China, but other Asian nations have leveraged the situation better than Vietnam, taking advantage of the lifting of quotas worldwide and the existence of integrated supply chains to drive down costs. In the words of one U.S. buyer in HCMC, "world garment prices are falling, and Vietnam cannot compete."

¶7. (SBU) The success of Vietnam's apparel industry has derived, in part, from low labor costs. Other costs, such as inputs (e.g. fabrics) and transportation, have always been higher in Vietnam than in other nations, but the combination of low labor costs, the high quality of Vietnam's production, and the worldwide quota system served to offset input and transportation costs in Vietnam. Now that quotas have been lifted for most of the rest of the world, Asian nations are using vertical supply chains to take advantage of domestic inputs to produce faster and at lower cost. Vietnam remains hampered by the fact that it still must import most of its inputs, which drives up costs and slows delivery of finished goods.

¶8. (SBU) At the same time, labor costs are rising in Vietnam. VITAS reported that a survey conducted by Vinatex showed that salaries of garment workers rose by 15 percent in the first six months of 2005, compared to the same period in 2004. One U.S. buyer said factories in HCMC and neighboring provinces of Dong Nai and Binh Duong were facing a labor shortage; these factories are stuck between increasing wages to attract workers and keeping costs down to compete with world garment prices.

¶9. (SBU) The result is that U.S. buyers are sourcing less of their product in Vietnam. MAST Industries, a subsidiary of The Limited, has reduced its production in Vietnam by 20 percent. Most of that production has shifted to Indonesia, which produces fabric domestically, in contrast to Vietnam. Li & Fung Trading Limited, a Hong Kong-based company that sources apparel for companies like Levi Strauss, Wal-mart and Target, is relocating its HCMC-based expatriate garment buyer to India.

MINISTRY OF TRADE AND QUOTA ALLOCATION

¶10. (SBU) VITAS and the HCMC Association of Garment-Textile-Embroidery-Knitting (AGTEK) agreed with U.S. buyers' view that Vietnam's Ministry of Trade (MOT) has not managed quota allocation as well as it could have and is partially to blame for under-utilized quota. Only on October 17 did MOT announce that manufacturers would be granted automatic visas - which speed up quota utilization - for certain categories; industry experts said MOT should have allowed automatic visas much earlier in the year.

¶11. (SBU) U.S. buyers are generally satisfied with MOT's responsiveness to their concerns. MOT still declines to issue quota based on past performance - the method supported by U.S. buyers - and instead prefers to reserve a small percentage of quota for discretionary allocation, for example to factories in remote areas. However, in September MOT agreed in principle to a proposal put forward by the Textile Committee of the American Chamber of Commerce that companies applying for quota in high-demand categories be required to submit a bank guarantee of 25-30 cents per piece in order to secure quota. Requiring a bank guarantee will discourage companies from hoarding quota, another cause of underutilization.

COMMENT

¶12. (SBU) In the short-term, the decline in garment exports to the United States may diminish the strength of the textile industry's pressure on the GVN to quickly accede to the World Trade Organization (WTO). One of the main drivers of Vietnam's WTO bid has been the potential for Vietnam's garment exports following WTO accession and the elimination of quotas. The decrease in exports and competitiveness, combined with underutilization of U.S. quota, casts into doubt the degree to which Vietnam's garment industry

needs WTO membership in the short term. As one U.S. buyer noted, SOEs receive the lion's share of U.S. garment quota; if orders are not likely to increase significantly following the elimination of quotas on Vietnam, the powerful SOEs have less motivation to encourage the GVN to accelerate its WTO bid.

¶13. (SBU) In the long-term, Vietnam's apparel industry needs to focus on the niches of the worldwide market where it can remain competitive. U.S. buyers agree that Vietnam is still the best place to source high-quality garments that require special embroidery and detail work, even if prices are higher and delivery slower. Certain industry leaders understand this, according to the buyers, but the rest of the industry and MOT are still - with an increasing lack of success - trying to compete directly with large-scale producers like China and India. Vietnam's textile and apparel industry directly and indirectly employs as many as two million workers. Textile and apparel exports in 2004 were Vietnam's second-largest export, after crude oil. Given the size and importance of the textile and apparel industry in Vietnam, its ability to maintain competitiveness has serious implications for the health of Vietnam's economy more broadly.

WINNICK